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Federal Communications Commission
Office of Secretary

March 31, 1997

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, NW, Room 222
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

Re: Ex Parte - GN Docket 96-245

Dear Mr. Caton:

On Thursday, March 27, 1997, I supplied a copy of the attached documents to Kerry Murray, Senior Legal Advisor of the International Bureau, but failed to file an ex parte notice with the Secretary's office. Accordingly, a original and two copies of this notice are being submitted to the Secretary of the Federal Communications Commission.

Sincerely,

Kristen C. Thatcher

Attachments

cc: Kerry Murray

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AT&T RESPONSE TO EUROPEAN COMMISSION GREEN PAPER ON A NUMBERING POLICY FOR TELECOMMUNICATIONS SERVICES IN EUROPE COM(96) VERSION 8.3

24 FEBRUARY 1997

INTRODUCTION AND EXECUTIVE SUMMARY

AT&T is pleased to submit its comments on the European Commission's "Green Paper on a Numbering Policy for Telecommunications Services in Europe (COM(96) version 8.3) (the "Green Paper"). We fully support the initiative taken by the Commission in addressing the issues raised in the Green Paper, many of which are crucial for the development of effective competition in the European telecommunications market.

In its response AT&T focuses on two substantive issues: carrier selection (or equal access) and number portability. In Section I we explain why full equal access is essential and why easy access (where a customer's calls default to the incumbent in the absence of the customer dialing a specific access code) is an insufficient solution to address the access bottleneck. We define full equal access to mean dialing parity with the incumbent and customer pre-selection with call-by-call override for all long distance and international services. All access providers should be required to implement full equal access with effect from 1 January 1998 (or as soon as possible thereafter) if liberalisation of the telecommunications market is to result in competitive benefits for customers. Customers should be informed of equal access through an independent notification and education process, supported by individual marketing campaigns, rather than compulsory balloting. Finally, AT&T strongly opposes the imposition of any surcharges payable by indirect access operators to access providers, because such surcharges inhibit competition.

In Section II we offer our proposals on service provider number portability, and in particular stress the need for prompt implementation of freephone and other special service non-geographic number portability. We describe interim switch-based and longer term database technical solutions for implementation of fixed local loop number portability, and urge the Commission to develop a timetable for implementation of database solutions, in consultation with the industry.

As regards the other issues raised (harmonisation of European numbering plans, the creation of European numbering space, naming on the internet), we have no detailed comments to make at this stage. However, before requiring Member States to implement numbering harmonisation

measures, we urge the Commission to weigh the benefits of such harmonisation against the significant costs and disruption which users and operators are likely to suffer if such measures result in major numbering changes in the Member States.

We urge the Commission to take prompt and effective action to implement equal access and number portability, as described below, preferably in the form of Article 90 Commission Directives.

I. Carrier Selection/Equal Access

The Commission recommends in the Green Paper that "Member States should introduce carrier selection, starting in 1998, with a solution where the local operator sets the default long distance carrier with a carrier selection override by the customer and moving towards a pre-selection by the user with override by the year 2000" (Green Paper p 16).

AT&T strongly supports the introduction of full equal access, but we consider that the timetable proposed by the Commission is too slow. Failure to implement full equal access at the earliest opportunity will impede the development of competition, particularly in long distance and international services. As the Commission states in the Green Paper:

> "the introduction of carrier selection is likely to bring large direct and indirect benefits to European society and economy. It is an essential element to bring increased competition on long-distance and international traffic which in turn could save the European economy as much as 20-25 BECU per year" (p i).

Having reached this conclusion, it is difficult to understand why there is any necessity for a phased introduction. An apparent justification is offered in Annex II:

> "With the implementation of easy access (Option A) operators will not lose market share in long-distance and international traffic as quickly and substantially as with the implementation of equal access (Option B) because they will normally elect to route their long-distance and international traffic via their own channels. Option A could therefore be an intermediate step in a phased approach to Option B as the medium to long term goal and cause a more gradual transition towards an open competitive market than with the implementation of Option B right from the start" (underlining added)

We fully endorse the Commission's conclusion that equal access is beneficial to the development of a fully competitive telecommunications market. However, we strongly disagree with the

concept of a managed transition to a competitive market which is aimed at protecting the incumbent's market share. Such a policy contravenes the Commission's Full Competition Directive[1], which requires Member States to abolish all special and exclusive rights of the incumbent with effect from 1.1 98 (later in countries with a derogation). There is no reference in that Directive to a gradual phasing out of such rights.

Failure to implement full equal access immediately will deny new entrants the opportunity to compete effectively with the incumbent for long-distance and international traffic, because the incumbent will, in the absence of a legal or regulatory requirement to the contrary, invariably route long distance and international traffic over its own network. Without full equal access new entrants seeking to compete with the incumbent for long-distance and international traffic will be significantly impeded in their efforts to capture outbound market share. This fact is confirmed by recent data in the UK in respect of the international market. From 1994 to 1995, British Telecom's market share of the public switched voice international facilities market (measured by minutes) remained relatively stable, declining by only .9% from 68.6% to 67.7%.[2] During the same period, the market share of Mercury declined from 28.1% to 25.5%, while new international resellers grew from 3.3% to 6.5% of the market.[3] This data suggests that the emergence of new international providers in the UK has had little effect on BT's position in the market. Instead, Mercury's market share drop reflects the churn among BT's competitors for that market segment already willing to switch from BT and to incur the inconvenience of disparate dialing protocols.

Opponents of equal access argue that it acts as a disincentive to the construction of new local infrastructure and favours instead indirect access operators who, according to such opponents, have made little investment in infrastructure. Such opponents stress alternative local access infrastructure as the key to the development of a competitive telecommunications market above

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1 Commission Directive 96/19/EC, 13 March 1996

2 Telegeography, Global Telecommunications Traffic Statistics and Commentary (1996).

3 Id.

all other factors and are therefore reluctant to impose full equal access obligations on the incumbent, let alone on new entrants in the local access market.

We strongly oppose this view and are supported in our opposition by a recent report produced by OVUM in November 1996 entitled "A new deal for telecommunications consumers: open access, the new regulatory paradigm", a copy of which is appended to this response. The OVUM report reaches the following conclusions[4]:

- Markets should be analysed and regulated from a customer's perspective. Customer choice should be the main determinant of market success, not regulatory decisions [such as promoting local infrastructure competition] biased to favour a particular structural outcome.
- Service innovation is independent of direct connection skills. Indirectly connected operators specialise in service creation and service management skills. Emerging service sectors such as the Internet demonstrate that local loop infrastructure is an access mechanism, not a service enabler.
- Indirect access based competition has been successful in a number of other markets. It provides a long-term choice to customers and is not simply a short-term alternative before local loop competition is established.
- The current emphasis on infrastructure-based competition [ie in the UK] may lead to the creation of ineffective competition characterised by local access monopolies or oligopolies. Indirect access would ensure this is not the case.
- The emphasis should be on services provided to customers, rather than solely on competition in the provision of physical infrastructure.
- Indirect access operators are making significant investments in service creation platforms and core network systems and have already created thousands of jobs in the UK.

OVUM further conclude that "effective carrier selection is a key determinant of competition across the board and is not, in itself, detrimental in establishing local loop competition. In fact,

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[4] OVUM report, pp 5-6

experience suggests that it re-inforces the need for customer ownership, hence providing an additional incentive for investment in access networks" [p. 17].

The Commission recognises the importance of equal access in the Green Paper. Our main concern with the Commission's proposals is the two-step approach in which full equal access is preceded by easy access. An obligation to provide easy access is better than no obligation at all to provide indirect access, but until full equal access is introduced, competition in the long distance and international telecommunications markets will be seriously impeded. Consumers will be denied the full benefits of competition by any regulatory policy which favours the incumbent over new entrants, or which favours construction of local access infrastructure and fully integrated telecommunications organisations offering services at every level of the market (local, long distance and international) over indirect access operators. Regulatory policy should not force new entrants into making economically unsound decisions by requiring them to invest at the outset in duplicatitive local access infrastructure at the expense of investment in new services and intelligent networks.

To the extent that regulators consider it necessary to introduce infrastructure competition in the local loop in order to put pressure on the incumbent for efficient access network provision, such competition can be created by utilising Cable TV ("CATV") networks and wireless in the local loop ("WLL"), provided, of course, that these technologies are not owned or operated by the incumbent. Both CATV and WLL enjoy economic advantages not available to other potential new entrants in the access market because of service scope or reduced cost technology.

In the remainder of this Section I, AT&T offers its views on the following specific implementation issues:

- what constitutes full equal access?
- who should have the obligation to provide equal access?
- cost structure and cost recovery
- customer notification and education
- timetable for implementation

What constitutes full equal access?

For equal access to be effective, it needs to include the following elements:

- dialing parity: Customers should be able to dial the same number of digits to obtain the services of an indirect access operator as they dial to obtain any equivalent services of the local access provider. If a customer is required to dial extra digits to select the services of a long-distance or international service provider competing with the local access provider, then the local access provider obtains an unfair competitive advantage raising a significant barrier to entry to new entrants[5].
- Preselection with call by call override: Customers need to be able to preselect their indirect service provider with the possibility of overriding that selection on a call by call basis.
- Applies to all long distance/ international services: Equal access should enable customers to access all indirectly provided services, not just international calls, and not just POTS. To apply equal access to only one segment of the market (for example, international voice services), as suggested by the Green Paper, will slow down the introduction of competition and protect the incumbent's position even longer.
- Indirect operators have direct relationship with customers for services provided by them: Under the equal access model, an indirect operator should be able to establish a direct relationship with a customer in respect of services provided by it.. This is critical to enable an indirect access operator to establish brand awareness. Without this, the role of the indirect

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[5] An additional problem arises where the incumbent's local switch is unable to process the number of digits dialed by a customer accessing the services of an indirect access operator. Under the ITUs "Time-T" directive introduced on 1 January 1997, the ITU allowed network operators to deploy national numbers of up to 15 digits. Although the UK has not yet done this, some countries (Germany and Finland) have already introduced some 15 digit national numbers. Thus, a customer of AT&T or another indirect access operator with a 4-digit access code, could be required to dial 22 digits: 4 (access code) + 3 (ISDN international prefix) + 15 (national). BT would therefore need to support 22 digits in order for all calls of customers of indirect access operators to complete successfully. However, BT's switches will only support 18 digits prior to May 1998 . In the UK recently, certain calls made by indirectly connected customers to certain locations in Germany and Finland were unable to be completed due to the length of the number dialed. Without the four-digit access code, it would have been possible for the calls to be completed. In other words, BT's customers enjoy a higher call termination success rate than customers of indirect access operators. If dialing parity existed, BT would not enjoy this unfair competitive advantage.

operator is reduced to a wholesale role in which it provides interconnect services to the access operator for the latter to brand as its own. This approach does little to enhance competition: if the access operator always retains the direct relationship with the customer, the customer will be denied the benefits of innovative pricing and customer care offered by new entrants in the long distance and international market. Furthermore, if new entrants in long-distance and international services are forced into a wholesale role, then it is the access provider who chooses the long distance and international carrier, not the customer.

AT&T strongly believes each of these elements must be present if customers are to benefit from competition. Evidence from liberalised markets demonstrates clearly that dialing parity (or near-dialing parity) is essential to incent customers to overcome inertia and take advantage of competition in the long distance and international markets. For example, in the UK, Mercury reached a 15% share of the long-distance market (national and international) over its first eight years. In Australia, Optus reached a slightly smaller share of the same market in 18 months. The main cause for the difference lies in the fact that in the UK, a customer wanting to use Mercury had to dial a three-digit access code and a twelve digit authentication code for every call (easy access). In Australia a Telstra customer wanting to use Optus merely had to dial a 1 at the front of the normal dialing sequence[6]. Although the latter is still not true equal access, the figures support the view that brevity of additional dialing requirements has a clear impact on the decision of a customer to select an alternative long distance and international service provider. An indirect access operator would need to compensate for the lack of dialing parity by competing merely on price to undercut the local access provider's competing long distance and international services. This creates an uneconomic price structure for new entrants which will be difficult to sustain over any extended period and will inevitably undermine the ability of new entrants to make the necessary investments to develop new and innovative services.

Who should have obligation to provide?

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[6] Source : Ovum report "Interconnect: the key to effective competition", 1994.

All access providers (the incumbent, new entrants and mobile operators) should be obliged to offer carrier selection to their customers. We urge the Commission to adopt measures under which customers are able to access all services from any access network. Failure to adopt such measures will deprive customers of choice, one of the most significant benefits of competition.

The case for imposing such an obligation on the incumbent is clear-cut. The Commission in its Draft Communication on the Application of the Competition Rules to Access Agreements in the Telecommunications Sector[7] addresses the issue of equal access in the context of abuses of dominance under Article 86 of the Treaty of Rome. In paragraph 97, the document states:

> " *Equal Access:* the possibility for customers of the party requesting access to obtain the services provided by the access provider using the same number of dialed digits as are used by the customers of the latter is a crucial feature of competitive telecommunications".

Failure of a dominant access provider (in most cases, the incumbent) to grant equal access to its competitors would therefore constitute a form of discrimination which would restrict competition and therefore violate Article 86.

However, if an obligation were to be imposed only on the incumbent, the customers of new entrants in the access market would be deprived of access to a range of service offerings, just because the product manager of their access provider has made a selection on behalf of those customers. This undermines and prevents customer choice and runs counter to the objective of opening up the market to full and effective competition.

Opponents of equal access argue that a new access provider would provide carrier selection for its customers by virtue of market forces, without the need for regulatory intervention. This is not supported by the evidence in the UK, where customers are offered vertically integrated packages in which the access provider selects a wholesale long distance and international operator. Thus, if

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[7] COM (96) 649 Final, Brussels 10.12.96

a customer wants to take advantage of competition which may exist in local services (for example, by switching to a cable operator offering entertainment and telephony services), that customer is denied the benefits of competition in long distance and international services. Customers should be entitled to access all services via all access operators.

Cost Structure and Cost Recovery

AT&T urges the following issues be taken into account in establishing an appropriate cost structure and cost recovery framework for implementation of equal access:

- Types of Costs to be recovered

  Only those incremental costs directly associated with the introduction of equal access should be recovered. Costs associated with normal network upgrades (ie network modernisation and normal capital planning projects, other regulatory requirements) should not be included in equal access cost recovery. Cost recovery should be on the basis of efficient costs and should include the following categories:

  - software costs
  - network costs, including local exchange and outside plant activities to perform the installation, testing, routing and translations. They do not include those costs associated with increased traffic requirements. Network reconfigurations resulting from changing access demand should be recouped through interconnection costs.
  - administrative costs, including costs associated with setting up administrative support to deal with change requests.

- Mechanism for cost recovery

  Once costs are identified, they should be allocated to all participating carriers, including, importantly, the access provider itself in respect of its own long distance/international traffic. Where a provider of equal access also provides its own long-distance and/or international services, then it must always be considered as a user as well as provider of equal access for

the purpose of cost allocation.

- Recovery Period

  It is critical that total costs be identified and capped to facilitate tracking and over-recovery and that any charges for equal access immediately be eliminated upon full recovery. Amortisation of the identified costs over too short a period provides a disincentive for entry: costs would be high during a new entrant's start-up period when capture of market share is very important for growth and long-term survival.

- Change charges to customers

  The first change from the incumbent access provider must be free to the customer, to ensure the customer is not deterred from selecting services other than those of the incumbent access provider.

- No Indirect Access Surcharges

  AT&T is strongly opposed to the levying of indirect access surcharges payable to access operators for potential loss of long distance and international revenues. Access operators should be free to rebalance local tariffs towards cost, thus obviating the need for any cross-subsidy from long-distance/international revenue to the local loop. If access providers are re-imbursed for revenue loss associated with equal access, then one of the benefits of competition would be forfeited: access providers would be exempt from the competitive spur to improve the efficiency and quality of their operations and from the need to become more responsive to customer needs.

  In any event, as the long distance/international market grows as a consequence of equal access, the access operator will be able to collect additional interconnect fees which such increased traffic will generate and thus access operators will ultimately benefit from the introduction of equal access.

Customer Notification and Education

In order for equal access to be effective, customers must be made aware of its availability and educated on how to select long distance services provided by carriers other than its access provider. Customers must be able to make informed choices. Failure to bring choice to the customers' attention results in inertia which inevitably operates to the considerable benefit of the incumbent.

AT&T is not necessarily in favour of balloting to achieve this objective. Experience in the US has demonstrated that although customer education and notification is critical, balloting results in high costs to the industry and is often confusing to customers. It is a one-off process which, if undertaken too soon after liberalisation, would place new entrants at a disadvantage. Furthermore, as the Green Paper recognises[8], balloting can result in a new entrant losing control over the quality and quantity of customers it acquires.

As a preferable alternative to balloting, AT&T supports the creation of national schemes for notifying all customers of the possibilities of equal access. Any notices would be created by the independent National Regulatory Authorities ("NRA") after consultation with the industry and would be followed by marketing campaigns by individual companies. Consideration should be given to excluding the incumbent from any such marketing campaign, given its inherent marketing advantages.

Timing of implementation

A systematic approach for the implementation of equal access is vital for its success. The NRAs should be responsible for developing a timetable for switch conversion after public consultation, so that the most important urban areas are upgraded first. There should be no requirement for a single national "cutover" to equal access: this will simply result in further delays in

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[8] Green Paper, Annex II, p 31

implementation. Finally, there is significant scope for abusive delays by the incumbent if the NRA does not develop and enforce an aggressive timetable for implementation.

II. Number Portability

The ability of a customer to change service providers without changing its telephone number is a critical feature in a competitive telecommunications market, necessary to promote effective competition between operators to the benefit of customers. The Commission has rightly identified service provider portability as a top priority.

In this Section II, AT&T offers its comments on timing of introduction of number portability for different categories of service, the essential elements of local number portability, interim and long term technical solutions for local number portability and finally the identification and allocation of costs involved.

Timing of Introduction of Service Provider Portability: the importance of accelerating non-geographic number portability

AT&T strongly supports the Commission's proposal to accelerate the introduction of service provider portability and agrees that 1 January 2003, the date set out in the proposed Directive on Interconnection[9] is too late to be effective.

However, the exact timing of the Commission's proposals is not clear from the Green Paper. On page 17, the Commission's proposals are stated as follows:

> "Member States should ensure that, where technical restrictions would still prohibit local loop operator portability, all necessary measures are taken to remove these as soon as possible, and at the latest that number portability is available in major centres of population by 1 January 2000."

and

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[9] Common Position EC No 34/96 220/03 29.7.96

> "Member States should ensure that any technical restrictions that still prohibit number portability for mobile and personal communication services as well as non-geographic services are removed as quickly as possible, and at the latest that number portability is available by 1 January 2000."

These proposals appear to give equal priority to all types of service provider portability. However, the summaries of the proposals contained on page iii and page 24 of the Green Paper indicate that mobile, PCS and non-geographic number portability will follow after fixed local loop portability.

The Commission should accelerate implementation of non-geographic number portability and should not wait until after implementation of fixed local loop portability. There are no major technical constraints to introducing non-geographic number portability and there is therefore no justification for delaying its introduction. In particular, the introduction of freephone number portability would provide an immediate boost to competition in the important market for freephone services, as it did in the US. In Annex III to the Green Paper, the Commission rightly cites the example of the success of freephone portability in the US where the FCC ruled for the introduction of number portability for freephone services to begin by 1993:

> "The new post-portability environment in the US calls for a centralised database and operational management system. This will enable all long-distance companies to reserve, activate and de-activate freephone numbers. When considering that over 40% of long-distance calls in the US ..... are freephone calls, the impact of this measure on competition in the US market is clear. Moreover, it has prepared US players better than European players for global services competition."

Growth in the UK 0800 market has been slow in contrast to the equivalent market in the US where it increased in size by 750% in the first four years of its introduction. Portability in this area will lead to an increase in competition, resulting in direct benefits to the customer such as reduced tariffs, innovative services, improved quality of service and a variety of customer applications.

Essential elements of local number portability

AT&T considers that the requirements for a true, full featured local number portability solution to promote the development and growth of a fully competitive local market are as follows:

- a customer can change local service providers and retain the same telephone number(s). All vertical and advanced features are available. Efficient procedures are in place to allow customers to port their numbers from one carrier to another.
- The local number portability network architecture does not subject new entrants to worse conditions than the incumbent, such as degradation of transmission quality, increased switching and transport costs, increased blocking, or increased call set-up time.
- All service providers are able to route calls efficiently and control their own costs of providing local number portability without requiring reliance on incumbent networks.
- All emergency and operator services are supported.
- Scarce numbering resources are used in the most efficient manner and administered in a competitively neutral manner.
- All carriers are able to bill all types of call.

The network architecture that would be necessary to provide this functionality would include:

- routing databases within carriers' networks that would identify the local exchange associated with the ported call; and
- a service management system (SMS) database and associated administration that would manage the database. Carriers would upload information to the SMS concerning their customers who have ported their telephone numbers. Information concerning all customers who have ported their numbers would be available for download from the SMS by individual carriers into their routing database for the purpose of properly routing and terminating calls.

Finally, in order to maintain the value and use of geographic phone numbers, the geographic scope of service provider portability should initially be limited to changing the service provider in the same local exchange area.

Interim and long term technical solutions

The above intelligent network database model for implementing local service provider number portability will not be available in the short term. However, this should not be used as an excuse to delay the introduction of number portability which could be implemented through less than perfect interim solutions, backed up by a timetable for implementing more ideal solutions, developed in consultation with the industry.

In the UK, three technical solutions have been cited to implement local number portability[10]:

- Tromboning: Calls are routed to the local BT exchange to which the called customer was previously connected. The exchange recognises the number as having been ported and adds digits so the call can be re-routed. The call is then passed to the BT trunk exchange and transferred to the other operator by the normal interconnect method. This is the only solution available immediately.
- Call drop-back: This is a more efficient version in which the local exchange sends a signal back to the trunk exchange permitting the call to be routed direct to the other operator. This solution could be introduced by BT late in 1997.
- Intelligent Network: A database held outside the switches is consulted at some stage during call set-up and supplies the switched with the information necessary to complete the call. This solution requires heavy capital investment. An interim IN solution with database reference points at appropriate points in the network could be introduced potentially by 1998/99. The full IN solution with database reference at the originating exchange would not be available until some time after 2000.

Tromboning and call drop-back are interim switch-based arrangements which use the capabilities and information which currently reside in the switch to route calls to ported numbers. They do

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[10] See UK Monopolies and Merger Commission report: "Telephone number portability: a report on a reference under section 13 of the Telecommunications Act 1984", November 1995, page 4.

not enable the essential elements of number portability described above to be achieved. A major problem with interim switch-based solutions is that the new entrant must rely on the carrier to whom the ported number was originally assigned to terminate all calls.

In order to reap the competitive benefits of the introduction of number portability, AT&T urges the Commission to require Member States to develop a timetable for implementation of intelligent network rather than switch-based technical solutions for the implementation of local service provider number portability. Such a timetable should be developed in close consultation with the industry.

Cost methodology and allocation

The recovery of costs for number portability must be accomplished in a competitively neutral manner. Network elements that are part of normal network upgrades, such as switch modernisation, should not be included in the cost calculation. The principles are the same as for costs of implementing equal access (see above). Costs should be calculated on the basis of total service long run incremental costs (TSLRIC).

As regards cost allocation, all beneficiaries of number portability should pay their proportionate share of the cost of implementing the capability. Local access competition benefits all end-users, including those who retain the incumbent for local services. Therefore the incumbent should bear its proportion of the costs to reflect the benefits to the incumbent's customers. These benefits include lower prices for services, better quality service, more choices and faster introduction of innovation services to meet customer needs.

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Jo Marks
AT&T Communications Services sa/nv
Brussels 24 February 1997

A new deal for telecommunications consumers - open access as the new regulatory paradigm

A telecommunications policy report

Huw Saunders
Stephen Young

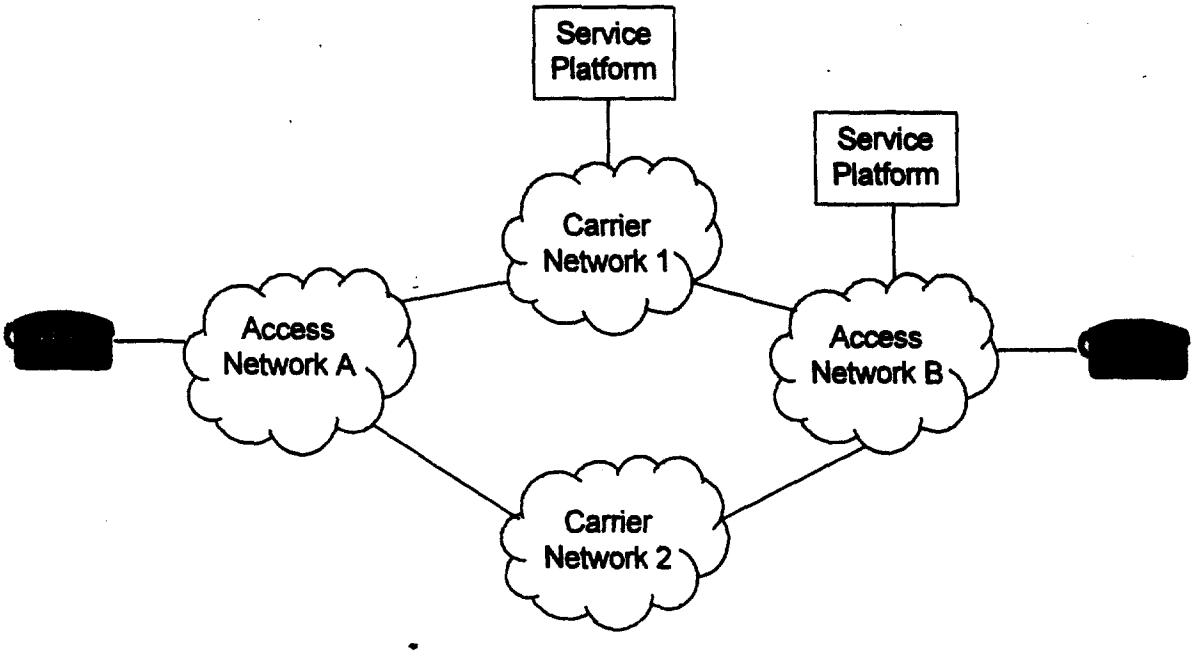
November 1996
TE511

2 A market model

In order to discuss the issues clearly, a consistent basic market model is needed. That shown in Figure 1 is used as the basis for analysis in this report.

Figure 1

A Competitive Network and Services Model



The model is based on three types of operator:

- access network operator (ANO)
- carrier network operator (CNO)
- independent service provider (ISP)

The three categories can be defined by their use and ownership of network facilities to deliver services to customers:

The ISP uses its own Service Platform(SP) plus network services from a Carrier Network (CN)

The CNO uses its own SP, and services from ISP's, plus its own Carrier Network (CN) services, plus Access Network (AN) services from an ANO

The ANO uses its own SP and services from ISP's, plus its own CN and CN services from a CNO, plus its own AN and AN services bought from other ANO's.

3 The UK today

3.1 Overview

It is a fundamental belief that effective competition brings benefits such as :

- innovation and choice
- efficient pricing
- a cost efficient industry (although there is a balance to be struck between more efficient individual operators and the resulting duplication of resources)

The UK model is biased to *AN based competition* (favouring operators with mainly directly connected customers) rather than *service competition* (favouring those operators (whether ANOs or CNOs) and independent service providers offering the best service to customers)

Why has this position been developed? The main arguments to date have been based on a few key factors:

- the main capital and running costs lie in the AN
- there is a basic need for competition to BT in the AN to drive out inefficiencies
- large scale investment is needed by new entrants and the ANmarket is not profitable in its own right, so there is a perceived need for special measures to encourage the investment levels desired

The main measures taken include:

- a ban on BT's entry into TV distribution to preserve the Cable operators monopoly
- new ANOs are not required to offer customers alternative access to other CNOs
- BT are not required to offer Equal Access with Pre Selection. This causes a considerable disincentive to the use of other CNO's services that can only be partially compensated for by additional discounting of service tariffs below the BT level.
- Number Portability in local service

These initiatives have resulted in considerable impact on the shape of the UK telecommunications industry:

- there has been major investment in AN competition - a multiplicity ofCATV operators, a number of national Wireless Local Loop operators, and a variety of regional fibre based operators operating in the major business and metropolitan areas(eg COLT, MFS, Torch, Scottish Telecom etc.)
- new local duopolies or oligopolies have been created that fail to deliver the full benefits of competition in services to customers
- there has been limited investment in CN competition and service innovation because of the structural barriers to effective customer access created by the regulatory primacy of local loop investment

There is a danger that this bias towards an oligopoly of vertically integrated AN based operators will lead to:

- lack of user choice
- reduction in potential demand
- excess investment and duplication of resources
- economically inefficient pricing

We believe that these dangers are sufficient to warrant a fundamental reassessment of the regulatory priorities.

3.2 The current regulatory framework

The UK was Europe's first telecoms market to be comprehensively liberalised. The Duopoly Review of 1991 resulted in the UK market being opened up to new operators. Government and the regulator now acclaim the fact that the UK has over 150 licensed PTOs.

But has the explosion in operators led to a subsequent explosion of choice for end users? Has the proliferation of telecoms networks led to a proliferation of inexpensive and innovative new services for customers? Are customers reaping the benefits from the rapid advances in technology? Or are there real barriers which prevent such benefits reaching customers?

In its second consultative document on price cap regulation, the UK regulator noted, *"Oftel wishes to open up the debate about the nature of competition in telecoms markets."*[2]. .We believe that this is right and proper, and furthermore that such debate should focus on the perspective of the customer, rather than the interests of a particular group of operators.

3.2.1 The market today - developing competition

Telecoms liberalisation in the UK has been based on the premise that competition in the provision of basic network infrastructure is a fundamental pre-requisite for effective competition. This construct is based on the sound economic logic that only competitive pressure will encourage real efficiency in the provision of any good or service. This is particularly important where the provider of one service (local loop access from an ANO) controls the means by which other services can be provided by a CNO or ISP.

Such competition in the provision of goods and services should be expected to give rise to a number of benefits to customers. Experience supports the theoretical contention that such benefits are varied and extend well beyond the simple virtues of reduced prices. Effective competition is characterised by a number of independent and efficient suppliers seeking to maintain or increase their share of a dynamic market. Competitors will seek to differentiate their product range through improved quality, and innovative features and facilities in order to achieve this which, in turn, leads to increased customer satisfaction.

The UK telecommunications industry has had competition for a number of years. This has resulted in a continuous decline in prices in most sectors, albeit at varying rates. Considerable service innovation has also occurred and service quality has improved dramatically, but it must be recognised that some of these changes may have been triggered by other factors such as general trends in infrastructure technology development.

Real competition in many sectors is still nascent. New operators have many disadvantages to overcome in entering the telecommunications market. Heavy investment is needed for the infrastructure to support their operations. Significant difficulties are faced in overcoming the structural advantages of the incumbent operators such as de facto technical standard control and the universal bottleneck of local loop access.

Despite the progress made, however, there is limited evidence that the current framework will ever provide effective competition for all customers for all services. In seeking to promote infrastructure competition, particularly in the local loop, regulation is being tilted to favour a desired outcome in ways that distort the underlying economic realities.

3.2.2 The UK regulatory model

The current UK regulatory regime continues to encourage a degree of vertical integration that is no longer an operational or technological necessity. It also seeks to encourage network competition by allowing service cross subsidy, and by allowing the generation of supernormal profits sheltered from effective competition. This is hardly economically efficient and there is ample evidence from other environments that other competitive models may deliver more beneficial results.

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[2] *Pricing Of Telecommunications Services From 1997,* March 1996, 3.15